THE CHANGING ECONOMIC ROLE OF THE STATE FROM A TURKISH PERSPECTIVE

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Abstract

The paper discusses from an institutionalist perspective the role of the state, with an emphasis on ownership traditions (private and public) in the Turkish case. A historical glimpse of ownership traditions is followed by an account of the rationale for both the *etatism* and " regulation by participation" as experienced during the Republican era. The paper discusses privatization and the new role of the state. An account is given of the present status of privatization, briefly evaluating the outcome. The effects of ownership structure on efficiency are then discussed. Finally, the new role of the state is outlined, emphasizing the need for a new form of regulation if public firms are to vanish and regulation by particiaption disappear. Workers' enterprises are suggested as an alternative form of privatization.

ملخص

تناقش هذه الورقة من منظور مؤسسى دور الدولة، مع التركيز على تقاليد الملكية (الخاصة والعامة) فى حالة تركيا. وبعد القاء نظرة تاريخية على تقاليد الملكية، يرد ذكر تفصيلى للاسباب المنطقية التى ادت الى أمرين:اشتراكية الدولة(الدولة الايتاتية)، والتنظيم عن طريق المشاركة بالشكل الذى طبقا به اثناء العصر الجمهورى. ثم تناقش الورقة الخصخصة والدور الجديد للدولة. تقدم الدراسة وصفا للوضع الحالى لعملية الخصخصة، وتقييم نتائجها بايجاز. ثم تناقش اثر هيكل الملكية على الكفاءة الاقتصادية. واخيرا، توضح الدور الجديد للدولة، مع التأكيد على الحاجة الى شكل جديد من أشكال التنظيم، اذا كان للشركات العامة ان تختفى، ولنظام المشاركة أن يتوارى. كما طرحت الورقة صيغة شركات العمال كشكل بديل للخصخصة.

Introduction: the age of economic design

The 'institutionalist' theme, most vividly spelled out by Douglass C. North (Nobel Laureate 1993), attempts to explain the existence and rationale of political, legal, economic or, in general, social institutions by reference to a model of interaction between individuals and institutions, where the latter are seen as "the rules of the game in a society or, more formally, [as] the humanly devised constraint that shapes human interaction" (North, 1990:3). In this framework, institutions are conceptualized, first, as providing the basic structure by which human beings throughout history have created order and attempted to reduce uncertainty; and, second, as determining, together with the technology employed, transaction and transformation costs and hence the profitability and feasibility of engaging in economic activity.[1] The analysis of institutional structures constitutes, therefore, a very important step in understanding both past and present economic performance, a critical evaluation of which might help us design and propose new mechanisms which would enhance economic performance.

The changing economic role of the Turkish state can also be viewed within this perspective. Based on observations relating to Turkey's past and present institutional structure, this paper will attempt to evaluate the role of the Turkish state, and then to propose new guidelines towards improving economic performance.

Turkey should perhaps be recognized as a self-inspecting, self-designing country, unlike the West, which is perhaps self-content, even complacent in part. Today in Turkey, discussions over a variety of institutional questions – ranging from reforming the electoral system to the economic and social implications of privatization, from the optimal size of parliament to the pros and cons of an alternative, presidential, system – are buoyant and attract wide and very active participation from very different strata, voicing a need for restructuring the present system. This reinforces our drive to focus on the formation and operation of institutions in Turkey, as the mode through which economies are organized and controlled

An institutionalist look over our shoulders

When Constantinople fell on 29 May 1453, the Podesta of Galata, the local Genoese settlement, quickly sought favor with the Turks. The latter ordered the gates to be opened, and Genoese envoys were sent out to request a confirmation of religious and

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[1] For a recent survey, see Hodgson (1993).

commercial liberties previously enjoyed under the Byzantine emperors.[2] It took only three days for Fatih Mehmet, as the new Eastern Roman Emperor, to sign this grant to the inhabitants of Galata, unilaterally guaranteeing their right to trade in his new and enlarged dominion, thus willingly foregoing his – and, what is more, effectively also his successors' – right to absolute and arbitrary rule in this matter. It is striking that he should of his own will choose to make such a promise, especially at a time when his power was at its peak, unchallenged by any other contemporary world power. His decision later received heavy criticism, but it was certainly a strategic one, undoubtedly setting forth crystal-clear property rights for a group of the world's best traders, giving them the most certain shelter of law and order, as well as protection from political interference. This was in a world in which everywhere else tradesmen had to bribe the local nobility and pay them tolls and fees at every crossroad, and a world in which extended religious and other wars and strife made trade no riskless occupation.

Another most striking fact about Fatih Mehmet's promise to the Galata inhabitants is its language. The document was written, not in Turkish, Italian or Latin, but in Greek, the language of the Eastern Roman Empire. Fatih Mehmet was not making a historical joke when he claimed the Eastern Roman Empire as its Emperor. And this should serve as a clear reminder to us all of what this young emperor did in the economic, legal, administrative and general social sphere. For he took over Byzantium, adopting and adapting much of its institutions, methods and administrative traditions and machinery to the needs of an expanding, energetic modern state composed of many ethnic groups, creeds, languages, and many and diverse needs. He did not crush the civilization that he had defeated at war. Instead, by exchanging blood with the basically nomadic traditions in administration that had brought the Oguz Turks in 1453, he gave the polity a new and economically viable life.

Unlike in a country following the Magna Carta tradition, where property owners got together to agree on the rules, Fatih Mehmet was, of course, the owner of all. But despite his omnipotence, he signed an accord which he must have thought would be good for business – <u>his</u> business. In so many ways, it is evident that Fatih was an institutionalist. The institution of fratricide was not his only mark on the future of the Ottoman Turkish state. He adopted and adapted Roman-Byzantine institutions and coined some of his own. The state as the business organization of its owner - the ruler - was a feature of the Turkish state well into the nineteenth century, exceptions being made to foreigners and minorities, which allowed them to own certain forms of property. A lesson

[2] From information given by the British Museum (February 1995), displaying the document of the next sentence. This document is also reproduced in Concina (1994).

to be derived from the Ottoman period is that the existence of clearly-defined property rights makes for good economics, thus escaping the uncertainties of vagueness and avoiding the commons problem by concentrating ownership in the hands of an individual – those of the Padisah. [3]

With the birth of the Republic in 1923, while subjects became citizens and the private ownership of property was placed on a pedestal, the large proprietor-state also undertook the duty of building itself up in order to function better in its new, self-ascribed duty of serving the nation, and this entailed its entering the economic world as a producer. Thus, during the period of *étatism,* the state aimed to establish the main industries, all in the absence of any private capital accumulation and despite a genuine shortage of human capital. Adopted as official ideology in 1931, *étatism* gained momentum in 1934 with the commencement of the five-year plan period, although it slowed down in the late 1940s. Here we were, again, at institution building, and the *étatist* order was designed to achieve a set of interrelated targets: building an infrastructure; producing a variety of intermediary/capital goods; creating human capital; ameliorating or curing regional imbalances; and, as an entrepreneur-state, bearing risk and confronting the typical uncertainties awaiting any new business in newly opened markets (Boratav 1974; Aysan and Özmen 1981; Karatas 1986; Kepenek 1990). These targets can be said to have been met with success: Turkey's GDP growth rate between 1929-1950 was 83 percent – a relatively high magnitude when compared, for example, with those of India, Egypt, Yugoslavia and Greece for the same period: 21, 59, 30, and -12 percent (Tezel 1982:450). The role of industry in the Turkish economy also grew during this period; its share in the GDP increased from 15 percent in the early 1930s to 19 percent in the late 1940s (Tezel, 1982:451). That is where the state took a leading position. Even in 1950, when the state started to step back from production activity, one-third of the value added in the manufacturing sector and more than the half of the value-added in mining were created by public enterprises (DIE 1953: 284). Another striking fact regarding what the state achieved in the *étatist* period is that, out of all entrepreneurs established between 1931 and 1940 and employing a work force of 50 employees or more in 1968, 78 percent had had an early work experience in the public sector – proving the state's contribution in enhancing the development of human capital (Soral 1974: 39-43).

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[3] It is worth recalling at this point that since 'exclusivity' – the right to determine who may use a scarce resource in a particular way – and 'alienability' – the right to reassign ownership to someone else – are both absent when the ownership of scarce resources is communal (to use the definition in Demsetz 1988), everyone would be individually better off by exploiting that communal property regardless of what others do, thus bringing about an inefficient outcome known as the 'tragedy of commons' (Hardin, 1968).

Later, starting in the late 1950s, we see the period of the mixed economy, or the period of 'planned industrialization', steered by the newly-established State Planning Organization (1961), which followed its own particular ideology. Here we observe the interesting institutional device of 'regulation by participation' (Sertel 1988) – a topic to be addressed below. Very Turkish, but also seen in Western Europe, notably in France, for example in the automotive industry (such as Renault), and in Italy. What we have here is the public hand entering production, not as a monopoly, but rather as one of several producers, and with the explicit goal of influencing – and, thus, indirectly regulating – the behavior of its competitors when the unregulated operation of private industry is unsatisfactory. As such, the participation of the public hand in productive activity exerts a regulatory effect on others, increasing the efficiency of the allocative operation of markets where competition is insufficient.

During these years main targets became the achievement of economic growth, structural change from agriculture towards industry, and the diversification of the export base of the country to finance increasing import needs of the economy. Along with this, the Turkish state aimed at developing import-competing product lines, and engaged in regulation of imperfectly competitive markets, even directly participating in production as well as giving overall support to industrial activity and exports. In this context, the first phase of the import-substitution regime, which aimed at replacing imports of non-durable goods, was successfully implemented between 1963 and 1973. Owing much to the changing international climate and external shocks, however, the attempt to substitute for imports of consumer durables, intermediate and investment goods, known as 'the second phase', proved to be no great success (Akder *et. al.* 1987; Boratav 1988; Önis 1993; Çakmakçi 1994; Kepenek and Yentürk 1994).

The years 1977-1980, preceding the 1980 adjustment program, are generally known as the 'crisis years'. This crisis was characterized mainly by macroeconomic instability as well as social and industrial strife. The country saw very high rates of price inflation, debt crises that went hand in hand with worsening international creditworthiness, and negative growth rates arising from supply bottlenecks and import scarcities due to foreign exchange shortages. Here, part of the problem had started with the oil shock and the consequences of Turkey's intervention in Cyprus in 1974, all of which placed the economy under severe strain. At the same time, economic difficulties were accompanied by political turmoil. Towards the end of this period, the government attempted to 'revitalize' the economy with a reform program designed by the direct participation of the World Bank and the IMF, which came into effect on 24 January 1980. The country then experienced a *coup d'état* in September of that year, and the military *régime* virtually suppressed all opposition groups and acted as a protector/guarantor of the 24 January economic program.

The reform program was a rather 'standard' one, arguing in favor of, *inter alia,* trade and financial liberalization, domestic demand restraint and suppression of the wage rate (Boratav, 1988:122 *et seq.*). What was new, however, was the accompanying discourse: For the last decade and a half we have been presented with a so-called new 'vision', which construes the state more or less as its disciples have perceived the United States – not necessarily as the United States is, but as they seem to have perceived it. This has brought us not only an ideology in favor of privatizing the state sector of the economy, but also a half-baked idea that we could more or less do without the state even in spheres such as public education and public health. It advocates a reduction of the role of the state in the economy but, ironically, its proponents have - if anything - extended the state's interference in more and more spheres of economic activity (Bugra 1994).

During this era of the supremacy of private over public, and of private property over public, again ironically, property rights – both public and private – have also become more and more vague. This is perhaps most evident in the simplest *tapu* (deed to a piece of land). This most central Ottoman/Turkish institution, still used in some parts of the 'old country', for instance in Israel, has been eroded in Turkey by the public hand itself. Indeed, the illegal occupation of private and public land has been encouraged by the public. The municipalities and parliament itself have been active in undermining the 'sanctity' of property – private and public – and the proponents of this 'sanctity' have been mostly to blame. It should go without saying that when someone builds an illegal wall, it should not be possible to forgive them and thus render their unlawful act legal. The cost is borne by the individual whose property is obstructed by the wall. Accordingly, theft cannot be pardoned by parliament and honesty expected to prevail. Where law and order cannot be guaranteed by the state, one can only speak of a return to the state of nature or of the filling of this vacuum by another, modern and more capable state. Needless to say, the lack of legal institutional arrangements also forms the basis for rent-seeking activities, as witnessed in Turkey. Respect for property rights would definitely imply a more efficient economic organizational structure.

Nevertheless, the privatization issue has been very visible our agenda for over a decade (Aktan 1993; Ertuna 1993; Önder 1993). This is so long a period for a goal to be achieved that it is evident that words spoke louder than actions. In fact, by the end of 1994, only about $2.3 billion worth of shares of public enterprises had been sold, and of these less than 30 percent were sales which turned over majority shares to private hands (PPA 1993). Of this magnitude, over a half was in a single industry, namely cement, where court cases took several years to settle. Among the cement factories sold, five went to a French company. The sales to the French company were made *en bloc*, and it is difficult to decipher what reasoning, let alone economic calculus, was pursued by the public agencies making the sales. The pattern proceeded from West to East and from the most to the least profitable. Little consideration seems to have been given to how the government's portfolio of loss-making enterprises was to be financed once profitable firms were eliminated. For the year ending in September 1992, had 11 of the 17 privatized cement factories not been privatized, the conglomerate ÇITOSAN would have had a profit of $17.5 million rather than a loss of $9.8 million (Tallant 1993). What is more interesting, if not dramatic, is that the estimated profits over four years for the five plants purchased by the French company added up, broadly speaking, to the price they paid.[4] Çakmak and Zaim (1992) also found that the private sector in cement has more or less the same physical efficiency (inputs/output) as the public sector, a finding that undermines the main rationale for privatization. The results reported in Tallant (1993) somehow confirm those of Çakmak and Zaim. Although private and mixed-ownership cement plants are estimated to be more efficient in terms of labor productivity than public ones, Tallant clearly acknowledges the fact that "the better showing in physical measures is closely related to geographic location, which indicates that the initial location decision has had more to do with firm performance than public ownership *per se*" (Tallant 1993: 99-100).

A great deal of debate has surrounded this matter, but even in an area where a nationwide consensus is said to exist, legislation to enact large-scale privatization has come only recently (27 November 1994), and many questions remain answered. This is not to speak of the nationalization of the steel industry (Asil Çelik), the dairy industry (Kars Süt), and in other instances where our private enterprise ideology has not hesitated to buy out failing private businesses. This is not to speak, of course, of the nationalization or otherwise bailing out of several private banks and financial institutions over the last decade. A very recent development (February 1995) in this regard was the attempt to sell two public enterprises (Kardemir and Et ve Balik Kurumu) to their dominant labor unions. The idea of transferring property and employers' rights to a labor union seemed to lack serious preparation and discussion, and proved to be sufficiently unworkable that the government, meeting with much criticism, had to reconsider its decision.

From the sluggishness of legislative action in privatization, as reported above, we could draw two types of conclusions. One is that the consensus in favor of privatization is not as wide and strong as claimed. Another is that we have evolved this state into one

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4 We owe this information to E. Çakmak and O. Zaim (Department of Economics, Bilkent University).

which simply cannot compose and pass requisite legislation, even where there is a strong consensus. There may be some truth in both of these. In support of the first view, the research of Ergüder *et. al.* (1992), for example, indicates that Turkish people in general do not have a strong preference towards private as opposed to public ownership.[5] This suggests that, in spite of the official discourse favoring privatization, in fact the cultural plasma of the country turns out not to be in agreement with the party line. As for the second view, if the legislative machinery is expected to be sluggish, as experience seems to confirm, this would mean that we should design a system which does not require frequent, fine-tuning legislative action.

The Privatization Debate[6]

It goes without saying that the crux of the privatization debate revolves around the relative efficiency performance of private versus public firms. To begin with, the efficiency criterion should be clarified. There seems to be a general tendency to treat efficiency as an indicator very closely related, if not identical, to profits. In the case of Turkey, for example, the usual public discourse on privatization tends to witness the presentation of loss figures pertaining to public firms as the rationale for a full-scale privatization. Of course, profit (as it appears in accounting statements) is in no sense a reliable indicator of efficiency, showing only the difference between sales revenues and costs. Instead, an economist must insist that the efficiency criterion should be conceived with the two usual components of productive (technical) efficiency, concerned with just how low a cost of inputs is incurred in producing any level of output, and allocative efficiency, concerned with how competitively the firm behaves in the markets.

First, regarding productive efficiency, the empirical evidence, generally speaking, tells us that, if anything, we are not in a position to conclude decisively which form of enterprise, public or private, is the superior form (Cave and Christensen 1980; Millward and Parker 1983; Vickers and Yarrow 1988). In the specific case of Turkey, such a comparative study seems to be a challenge. In order to accomplish such a study, however, three different methods can be used. (For a recent discussion on Turkey, see Boratav *et.*

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[5] A total of 1030 subjects were asked to indicate their preferences regarding the ownership status of enterprises on a scale of 1 to 10, 1 standing for pure private property and 10 standing for pure public property. Those who reported 1 and 2 (strong support for private ownership) constituted 18.4 percent of the total sample, as compared with 31.6 percent who reported 9 and 10 (strong support for public ownership). As this research constitutes a part of an international study, its results can also be compared with those for other countries. Of the 23 countries covered in the larger study, only in Nigeria did people indicate a stronger preference for public property than in Turkey.

[6] Some parts of this section draw on Adaman (1993).

al. 1993). The first one is to directly compare the efficiency (such as labor, capital and total productivity) figures of private vs. public firms. Although from a methodological point of view there seems to be nothing wrong with this approach, it requires the compared private and public firms to share similar structures, both technologically and environmentally. In the case of Turkey, this condition is very difficult to meet, unfortunately, as one very seldom finds firms of different ownership structures in similar relevant conditions. The cement industry turns out to be an exception and, as indicated in the two studies cited above, here one can safely claim that public and private firms are generally on a par in technical efficiency. The second way of comparing the efficiency of public versus private plants is to conduct a cost-benefit analysis by computing inputs, outputs and value added on the basis of social prices. An obvious difficulty here lies in the computation of social prices. The third method is to estimate production functions of private and public firms and then contrast them on the basis of the differences between their potential and actual output levels. The difficulty here has to do with the unsettled debate about the methodological problems regarding the definition of production functions. In view of such methodological problems, a full-scale comparison has yet to be conducted for the case of Turkey. A partial analysis, however, could pinpoint the fluctuations in public firms' efficiency over the years and then try to explain their variations. This path has recently been explored by Boratav *et. al.* (1993), and their finding is that productivity figures started to deteriorate in 1987 over the 1980-1992 period. Further investigation has led them to conclude that this deterioration has a strong correlation with the decline of investment expenditures.

The productive efficiency question is typically approached via the principal-agent theory, which focuses on the effects of ownership on the monitoring of a managerial body. Public ownership of a firm is not the ownership of the firm by the general public in the pure sense of each citizen owning a tradable share in the firm. Rather, the firm is owned by a public agency which acts as proprietor on behalf of citizens. Under private - as opposed to public - ownership, it is claimed that two separate mechanisms would ensure that managers do not deviate from profit maximization (Pryke 1981; Demsetz 1988). The first consists of shareholders' control over managers, and the second is the discipline implemented by the capital market in the form of takeovers and the difficulty in raising additional capital. In the first, it is argued that the voting mechanism gives shareholders ultimate control over management. Shareholders, being the residual claimants, bear the direct consequences of managerial actions and therefore have the ultimate incentive to control the management team, with the implication that once inappropriate behavior by managers is detected they will be subject to dismissal. In the second, it is claimed that when misbehavior of managers is reflected in the stock and bond prices of the firm, two mechanisms will be operative, thus disciplining managers. For one, if a management team is performing poorly, a potential takeover bidder may see this as an opportunity and purchase the firm, and the new management will run the firm more efficiently. In addition, inefficient managers will find it more difficult to raise additional capital, and in the final analysis might have to face bankruptcy.

Yet, the above explanation has a few flaws. First, regarding shareholders' discipline, two reservations have to be noted. The first has to do with the implicit assumption that shareholders always maximize their (expected) profit from the company. There might well be some cases (e.g. consumers of a monopolist's product holding a substantial fraction of its share) in which a rational shareholder would find it beneficial not to ask the manager to maximize the firm's profit (Hart 1979; Vickers and Yarrow 1988). As for the second reservation, if all shareholders hold insignificant fractions of the total securities of the firm, none would have much incentive to monitor the firm's performance. As Stiglitz asserts (1985: 136):

"Since there is always some cost associated both with obtaining information to determine whether a manager is a good manager and with evaluating alternative management teams, in other words, to voting intelligently, and there is a negligible benefit, no rational shareholder should expend the resources required to vote intelligently."

Furthermore, the discipline of the capital market is not without its own problems either. Regarding its alleged effects on takeovers, three reservations can be raised. First, faced with the observation that a firm is not performing well, a potential bidder must know whether this poor performance has arisen due to bad management by the existing managerial team <u>or</u> due to some exogenous conditions which were beyond the control of the existing team (such as mistakes made by previous management), thus bringing about an information problem. Secondly, the incumbent management team could pursue a set of strategic actions in order to avoid being taken over. Thirdly, foreseeing a takeover offer, a typical rational shareholder would find it profitable not to sell his shares, waiting rather for the takeover to be finalized, after which his share would sell for a higher price. Regarding the difficulty in raising capital, two drawbacks must be noted. First, only the managers of firms with attractive investment prospects are likely to concern themselves with the efficient utilization of resources in order to raise additional capital. As Stiglitz (1985:139) argues, "for other firms with poor investment opportunities, the threat of the denial of access to future capital is not an effective control mechanism". Secondly, should the probability of bankruptcy arise, the managerial team may think that the firm will go out of business regardless of the decisions they make, and so may decide to enjoy managerial discretion to the fullest possible extent in the short term (Vickers and Yarrow 1988). Therefore, as in the case of the threat of takeover, difficulties in raising capital may cause the management team to shorten decision-making horizons.

Taking all these drawbacks into account, there exists no solid ground for the argument that under private ownership the monitoring of managerial activities will be done efficiently. Dispersed shareholders will be inclined to free-ride, and capital markets need not function efficiently enough to exercise discipline over managers. Yet, if we were to insist that a capital market, however inefficient, will have an efficiency-enhancing role in the sense of taming managers, then it seems plausible to imitate the functioning of a capital market under public ownership, as Bardhan and Roemer (1992) recently proposed.

In Bardhan and Roemer's scheme, the government initially distributes a fixed number of coupons to all citizens, who use them to purchase the stock of firms, denominated not in regular currency but in said coupons. Owning a share of a firm entitles the citizen to a share of the firm's profits. The shares of firms cannot be purchased, but they can be traded for shares in other firms. Prices of coupons will therefore oscillate as they do on a regular stock market. Everyone's coupon portfolio must be returned to the public treasury at death, and allocations of coupons are continually to be made to new generations. This 'pseudo' stock market, then, "should provide the same signals that a capitalist stock market does, apart from providing some risk-bearing by citizens", forcing managers to act properly (Bardhan and Roemer 1992:110). The conclusion to be drawn is that, facing the issue of monitoring managers, the effects of ownership structure on productive efficiency may be *a priori* indeterminate.

The issue of productive efficiency has a second dimension as well. Many matters which cannot be effectively steered right by proper organization (for instance, via proper principal-agent relations) and by proper management can only be set right through an appropriate partnership market where providers of resources can buy in as partners or can be bought out by others who offer enough to purchase their partnership deeds. The literature on workers' enterprises (WEs) and, more generally, about 'factoristic firms' (Sertel 1991) centers its analysis on a partnership market which determines the efficient employment of factors of production without an employer (e.g., an entrepreneur or a labor-managed firm's (LMF) management) deciding on how much of these factors to hire subject to a price schedule. After all, it is thanks to the worker-partnership market that a WE behaves as if it were a profit-maximizing entrepreneurial firm, although it has no entrepreneur deciding on the employment of labor, a factor of production that it can employ only as embodied in its partners.

At this point, it would be wise to outline briefly the distinction between WEs and LMFs in order to better understand what a worker-partnership deed market would bring us. The tradition following the contributions of Ward (1958), Domar (1966) and Vanek (1970) takes as its point of departure the assumption that in LMFs the aim is to maximize the dividend per worker-member, defined as the value-added per worker. More specifically, the LMF chooses inputs in the short and long run so as to maximize the value-added per worker. The consequence of the Ward-Domar-Vanek assumption regarding the behavior of LMFs, however, is that of inefficiency and perversity. (For a general discussion see, for example, Bonin and Putterman 1987, as well as Kleindorfer and Sertel 1994).

To begin with, three main problems are expected to arise when capital is assumed to be fixed. First, LMFs will be smaller than their capitalist twins if profits are positive. Note that if there is a positive profit, the profit that goes to shareholders in a capitalist twin firm would be divided among workers in a LMF, making the value-added per worker greater than the ongoing wage rate. Assuming that the marginal product of labor is decreasing, the LMF has to use, under the positive profit scenario, less labor in order to attain the optimality condition, bringing about inefficiency. Moreover, LMFs would behave perversely in response to autonomous shifts in the product price, lowering (increasing) their labor force, and thus output, when the price rises (falls). Lastly, if there is a positive profit and the value-added per worker differs among LMFs, labor allocation in the LMF economy would not be Pareto optimal. Clearly, a reallocation of labor toward the LMF with the higher value-added per worker from the LMF with a lower one would increase total output in the economy. The main problem in the long run, on the other hand, is that if there is a positive profit, the maximized value-added per worker will exceed the ongoing wage rate, thus the choice of technique will be more capital intensive than the optimal combination level. Finally, an under-investment malady has long been attributed to LMFs: Due to the anticipated finiteness of their tenure, members, unable to fully appropriate the cash flow results of internal investment, would adopt a higher effective discount rate and underinvest (Furubotn, 1976). Furthermore, as Fehr (1992) noted, due to the fact that initial members of LMFs are subject to expropriation by newcomers, there would again be an incentive to underinvest. In other words, incumbent workers cannot internalize the benefits from growth, even if they bear the cost of growth.

The conclusion to be drawn is that the design of LMFs is fundamentally flawed. The main surprise, however, is that they have occupied, and still occupy, the attention of so many economists to date. (For a relatively recent contribution see, for example, Drèze 1989). There have been many attempts to cure this flawed structure. (For a review, see Bonin and Putterman 1987). Yet, none has succeeded in properly answering all the above deficiencies.

Should the firm's shares and capital structure be valued and sold to employees, however, then the persistent perverse and inefficient character of the LMFs would vanish. This avenue was first explored by Sertel (1982), with further contributions by Dow

(1986), Sertel (1987 and 1991), and Kleindorfer and Sertel (1994). In Sertel's system, any expansion of the membership list requires the approval of both newcomers and current members. Likewise, any contraction can only be realized if those who retire as well as those who stay give their mutual consent. Therefore, not only does the WE unanimously agree to adjust capital variable so as to maximize the value-added per worker, but also the size of the membership list is itself subject to the worker-partnership market. As such, "[a] deed price at which no sellers can find buyers and no buyers can find sellers will not only be an equilibrium deed price, but will also correspond to a rest point in the formation of the firm and to an equilibrium firm size" (Sertel, 1987: 1621; our emphasis).

Obviously, the issue of how efficiently this deed market would function still remains, and one may assume that imperfections similar to those which were mentioned in the case of capital markets are likely to repeat themselves. Parallel to what has been said above, however, it is possible to claim that an intermediary organization might facilitate the functioning of this deed market. Indeed, the experience of the Mondragon cooperative movement in the Basque region of Spain seems to support this claim. On an *a priori* basis, it should not be possible to claim the advantage of one type of market over the other.

Two types of lessons may be drawn from the above. For one, the divorce of public firms from an ownership market could very well be the cause of economically pathological behavior on their part, even if they were not subject to the politically valid favoritism syndrome outlined above. Furthermore, as WEs do not suffer from this divorce from an ownership market, or from any divorce of ownership from management, they may very well offer a viable alternative form of private organization and ownership structure for the public firms which we may want to privatize. (For more along these lines, see Sertel 1995f).

The whole corrective and regulatory device of an ownership market is dispensed with when we place a firm under the vague 'public' ownership of the citizenry rather than issuing tradable shares to citizens. By selling or giving shares to the citizens, for example by selling or giving shares to the employees of public firms, we can directly cure these firms of at least this one structural handicap. When government privatizes a firm, instead of issuing stock to the citizens and allowing them to trade, it may prefer to sell stock in their name, for the latter course allows the government to decide also on how to spend the proceeds of the sale. The citizens may, however, prefer to decide for themselves on how to spend their own wealth, for public firms are, after all, the citizens' property.

After having discussed the productive efficiency aspect of different ownership structures, let us now turn our attention to the issue of allocative efficiency.

When the operation of private industry is unsatisfactory due to imperfections in competition, two alternative forms of public intervention in regulating the malfunctioning of these markets seem to have been traditionally considered. One alternative is for the public to appoint a regulatory authority in charge of curing the imperfections arising due to such an imperfection, with the aim of increasing the industry output to the level that would occur under perfect competition, and this with a menu of various tools to apply. The second alternative is for the public itself to produce the output in accordance with said allocative efficiency criteria (Bös 1986). Although from a theoretical perspective the two alternatives should produce the same allocative outcome, the empirical evidence clearly indicates that publicly owned firms are generally readier to undertake measures to enhance allocative efficiency (Vickers and Yarrow, 1988). A third - hybrid, alternative - 'regulation by participation' (Sertel 1988) aims to insert public firms in an imperfectly competitive environment in order to prevent the monopolization of the market and the exploitation of the consumer. The behavior of the public firm entering into an imperfectly competitive situation would influence the behavior of its competitors or fellow inhabitants in the industry, and its participation would thus have a regulatory effect on others. "A public enterprise is to be judged, therefore, not in terms of its own efficiency alone, but also in terms of its effect on the efficiency of the industry as a whole" (Sertel 1988: 112). As we have mentioned above, this mechanism has been, and still is, applied in the case of Turkey, correcting many allocative problems and thus increasing social welfare. What is very striking in the privatization debate in Turkey is the almost total lack of reference to the regulatory functioning of the public sector, although this institutional device has been especially important in this country.

Looking forward

If we were now to look forward as economic designers who understand the critical role of institution-building for the wealth of nations (as the old economists would call what we now refer to as social welfare), what general principles might we wish to lay out as guidelines for the future institutional design of this society? The choice of which particular institutional design one should prescribe is a highly technical question, and hence beyond the scope of this paper. It is bound to remain a topic for debate over many years to come in a society like Turkey, which continually seeks self-improvement by conscious design. We should, however, ask for guidelines which say something about the major aims of legislation and its enforceability, and we should inquire as to whether there is anything special about Turkey which might alert us to the need for one attribute in our designs more than others. In asking these questions, we should keep abreast of all historical and social psychological information pertinent to Turkey.

In answering "What creates efficient institutions?", we should perhaps start by asking whether there is a possibility that Turkey's institutional structure may lack the formal enforcement structure that underpins efficient markets, causing informal activities to step into this vacuum. Such an informal structure would come with high costs, however, "because the lack of formal property right safeguards restricts activity to personalized exchange systems that can provide self-enforcing types of contracts" (North 1990: 67; a footnote is omitted). This surely constitutes one of the economic institutional realities of Turkey, but its magnitude is hard to judge in the absence of relevant research.

In seeking how to build and enforce institutions, we might want to keep our minds open to the wisdom encapsulated in a couple of sayings which probably reflect relevant social psychological background information. Let us recall these two very telling Turkish sayings to reflect the Turkish setting of social values, traditions and expectations in whose context institutional design has to be contemplated in this country:

Sayings:

A. "Türk, tavsani kagniyla avlar." (A Turk will hunt down a hare with an ox cart.)

B. "Padisah yasagi bir gün sürer." (The Padisah's forbidness will last but a day.)

Lessons for the designer of economic institutions:

a. Devise rules which are simple to judge, because some legal processes, although they may ultimately catch the culprit, may take very long.

b. Devise rules which are difficult to change, and make sure that those who infringe such rules will be punished accordingly.

These combine to imply rather mechanical, automatic, irreversible sanctions, leaving little room for human judgement, hence entailing little rent-seeking in courts. Accordingly, the plunder of common or private property will be discouraged if pardons are no longer available and offenders are actually prosecuted.

But there might be more to the issue than simply higher transaction costs. The totality of institutional constraints may define a set of payoffs to political and economic activity that would not encourage unproductive activity. As claimed by North (1990: 67):

"With insecure property rights, poorly enforced laws, barriers to entry, and monopolistic restrictions, profit-maximizing firms will tend to have short time horizons and little fixed capital, and will tend to be small scale. The most profitable business may be in trade, redistributive activities, or the black market. Large firms with substantial fixed capital will exist only under the umbrella of government protection with subsidies, tariff protection, and payoffs to the polity – a mixture hardly conducive to productive efficiency."

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